

## The Game of Sanctions

Jelica Minić

*The FR of Yugoslavia has become, to a great extent by its own merit, a testing range for a large variety of the international community's punitive tools, including military intervention. During 1999 only, the EU published in its official journal 19 postulates, decisions and decrees of castigating nature in connection to the FRY, while during the first six months of year 2000, it published another 13 similar documents by which punitive measures towards the FRY were modified, supplemented or newly-introduced. One of the recent measures that attracted a lot of attention - the introduction of black and white lists of Serbian companies that are prohibited, or permitted to do business - represents yet another document in the tiresome "cat and mouse" game, which seems endless. Who is the winner, and who the loser of the game? In neither case can prosperous business interest be on the winning side.*

Companies from the white list, which are "favored" by the mentioned decree, are in fact marginal participants in the Yugoslav economy that have become victims of their "independence" from the regime and are now subject to a large variety of pressures and prohibitions. The EU has very efficiently hindered those who might really deserve to be helped. Their partners from abroad are also unsatisfied with the decision, as are the partners of other Yugoslav companies that bear the brunt of the new EU measures. Moves that have had similar effects are already hard to number.

Let us consider, for instance, international air transport to and from FRY, which had been banned on several occasions, and permitted over again. In former Yugoslavia, 80% of international passenger transports in 1989 departed from Belgrade airport. Out of 3,500,000 passengers, 1,900,000 traveled to foreign destinations, 1,100,000 of who

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FRY Basic Economic Indicators	1999	1999	VI 2000	VI 2000	VI 2000	I-VI 2000
		1998		V 2000	VI 1999	I-VI 1999
<b>GDP - USD million</b>	<b>14,224<sup>a)</sup></b>	<b>-19.3%</b>	...	...	...	...
Montenegro	...	...	...	...	...	...
Serbia	...	...	...	...	...	...
<b>GDP per capita - USD</b>	<b>1,699<sup>a)</sup></b>	<b>-19.1%</b>	...	...	...	...
Montenegro	...	...	...	...	...	...
Serbia	...	...	...	...	...	...
Central Serbia	...	...	...	...	...	...
Vojvodina	...	...	...	...	...	...
<b>Industrial Production</b>	...	<b>-24.1%</b>	...	<b>-2.0%</b>	<b>48.7%</b>	<b>19.7%</b>
Montenegro	...	-7.6%	...	10.9%	-4.1%	-1.2%
Serbia	...	-25.6%	...	-2.7%	53.9%	21.2%
Central Serbia	...	-24.5%	...	-2.0%	55.0%	23.9%
Vojvodina	...	-28.2%	...	-3.9%	51.7%	15.1%
<b>Average Wage - DM</b>	<b>107</b>	<b>-31.7%</b>	...	...	...	...
Montenegro	154	-14.1%	189	0.5%	23.0%	7.9%
Serbia	102	-33.8%	91	2.1%	4.2%	-26.1%
<b>Unemployment Rate<sup>b)</sup></b>	<b>27.3%</b>	<b>8.3%</b>	...	...	...	...
Montenegro	36.8%	7.9%	...	...	...	...
Serbia	26.5%	8.2%	...	...	...	...
<b>Export - USD million</b>	<b>1,498</b>	<b>-46.9%</b>	<b>150</b>	<b>3.8%</b>	<b>69.8%</b>	<b>12.8%</b>
Montenegro	123	-4.7%	13.9	6.0%	13.9%	43.1%
Serbia	1,375	-48.9%	136.2	9.0%	78.7%	9.9%
<b>Import - USD million</b>	<b>3,296</b>	<b>-30.3%</b>	<b>272.6</b>	<b>-12.4%</b>	<b>30.9%</b>	<b>33.8%</b>
Montenegro	358	6.9%	19.1	-46.6%	-27.9%	-14.0%
Serbia	2,938	-33.2%	247.9	-19.2%	131.5%	37.1%
<b>Monetary supply (M1), end of period, DIN billion</b>	<b>16.4</b>	<b>51.9%</b>	<b>22.0</b>	<b>17.4%</b>	<b>71.5%</b>	<b>53.6%</b>
Cash	6.7	34.0%	7.5	30.5%	39.6%	26.5%
Deposits	9.7	67.2%	14.5	11.6%	94.4%	73.2%
<b>Real money supply, end of period, DM million</b>	<b>739</b>	<b>-42.3%</b>	<b>824</b>	<b>20.1%</b>	<b>-25.6%</b>	<b>-39.7%</b>
<b>Market exchange rate, monthly level</b>	<b>4.25%</b>	<b>-38.8%</b>	<b>5.83%</b>	<b>7.4%</b>	<b>165.0%</b>	<b>10.9%</b>
<b>Retail prices</b>	...	<b>42.4%</b>	...	<b>4.2%</b>	<b>66.2%</b>	<b>57.0%</b>
Montenegro	...	60.1%	...	2.9%	154.2%	139.0%
Serbia	...	41.1%	...	4.3%	60.6%	51.7%
<b>Cost of living</b>	...	<b>44.9%</b>	...	<b>3.9%</b>	<b>74.4%</b>	<b>64.9%</b>
Montenegro	...	67.2%	...	1.8%	159.3%	149.7%
Serbia	...	43.5%	...	4.2%	68.4%	58.0%
<b>Industrial prices</b>	...	<b>44.2%</b>	...	...	...	...
Montenegro	...	63.7%	...	...	...	...
Serbia	...	43.2%	...	...	...	...
<b>Black market exchange rate (din/DM)</b>	<b>12.6</b>	<b>88.1%</b>	<b>23.1</b>	<b>1.7%</b>	<b>109.1%</b>	<b>126.4%</b>

<sup>a)</sup> G17 estimate based on official information from the Federal Statistics Office

## Obstructed communication aids tyranny

## Business interests have supported transition in Southern Europe

## Existing strategies are insufficient

## Focus on incorporating rather than excluding the private sector

flew by foreign flight companies (PANAM, LUFTHANSA, SAS, AIRFRANCE, SWISSAIR, AEROFLOT, etc).

If we look at the social structure of Yugoslav passengers on international flights, we conclude that 80% belong to the working class of West European countries (economic emigrants), emigrants to America, Canada and Australia, as well as their relatives that go on visits. Therefore, "ordinary, small" people are harmed the most, those who can in no way take the blame for the policy (and undeniable crimes) of the regime.

The main losers are, therefore, ordinary citizens of Serbia and Montenegro as well as the domestic and foreign companies that do business on these markets. Here we will not enter the issue of other political, social, medical, and psychological traumas related to international isolation. Aristotle warned that an obstruction of communication is one of the best ways to maintain tyranny. Today, 2350 years later, we can only confirm that he was right.

### Changes - the interest of Serbian economy

Democratic changes in Serbia are not possible if important segments of Serbian economy fail to recognize them as in their own best interest. In the mid-seventies, economic circles in Spain, Portugal and Greece blessed the end of the era of authoritarian regimes in Southern Europe and turned toward the European integration that upheld the peaceful transformation of their societies. With more or less enthusiasm, the same is now happening in Central and Eastern Europe.

It could be said that economic circles in Serbia were not the chief conveyers of war and nationalist option in the early nineties, but they were also not ready to give decisive support to a reform option of the last Federal Government, which offered peaceful changes. Business circles did not influence sanctions that the regime introduced against Slovenia, Macedonia, Republika Srpska, or, presently, Montenegro. Serbian intelligentsia, military and religious circles, and even many opposition parties supported and articulated the nationalist program of the state-party oligarchy, which was later to harm the population, economy, and even the natural environment. War and international isolation disabled every attempt at economic and social reform. A specific, perverted transformation did in fact happen, but through a war economy and the criminalization of society, and not on the basis of a democratically established social consensus on the formation of a new system of values and institutions.

The role of the international community in the crisis and conflicts of former Yugoslavia is also controversial. The quick recognition of independence for Yugoslav republics, the introduction of EU and UN sanctions, and lastly, the NATO military intervention all lead to justifiable questions about the efficiency of the chosen measures and the judgement of the ones who passed them.

The European Commission document entitled *The Stabilization and Integration Process for Southeast European Countries* (Brussels, May 26th, 1999) discloses a sincere and clear explanation. During the past ten years, the EU encountered three large geo-political challenges - the emergence of new independent states in Central and Eastern Europe, the breakup of the former Soviet Union, and the crisis and conflicts in the "West Balkans". Each of these required the development of a new set of policies and instruments. The offered response is "a perspective of integration, based on gradual approximation that is adapted to the situation in each respective country". In other words, this document defined a regional approach with consideration of different conditions in specific countries, as did the Pact on Stability for Southeast Europe. The busy EU agenda marked out a timetable for Southeast Europe after a delay of ten years. All the rest can be regarded as buying time until more urgent problems are taken care of (the immediate eastern border and an always-menacing Russia).

In order to ensure the new regional strategy's effectiveness, it is necessary to include Serbia - there is general consent over this matter. In order to include Serbia, it is necessary to lift sanctions. In order to lift sanctions, it is necessary to achieve political changes. How can political changes be achieved in a country with a closed economy, a large degree of state control and intervention, and an authoritarian regime that increasingly resorts to repression?

Is the strategy of "dismantling" the authoritarian system by incorporating particular groups of people, who play a significant role on the internal scene, into regional and European cooperative and integrative processes sufficiently fast and effective? The Szeged process for "free towns and municipalities in Serbia", the Timisoara initiative for "free media", the Graz process that involves alternative educational structures, the Royaumont process that includes non-governmental organizations, nonstandard humanitarian assistance (energy for democracy, asphalt for democracy, schools for democracy), the networking of independent institutes and research centers, as well as continuing and strenuous work with the opposition in Serbia are surely efforts that deserve attention.

### Entrepreneurs for partners

But what is to be done with business circles in Serbia? Do they entirely identify with the regime? How can they be persuaded that their best prospects lie in opening the country and international cooperation? How can they be won over and involved in accelerating the process of changes? Certainly not by applying the policy of general and "selective" sanctions, as was done so far. Their effects are obviously limited and very often counterproductive. Instead, attention should be focused on incorporating, not excluding, business enterprises in Serbia into the swift process of changes that is taking place in their environment, into challenging regional investments, into adapting to legal and institutional standards of successful business as they function in Europe and the rest of the world, and into the indispensable process of learning and competing.

Yet, those who advocate further punishment and isolation will say that a highly compromised state-party oligarchy, war profiteers and mafia run the economy in Serbia. This is an indisputable statement. However, there still exists a firm managerial and expert class that has been pushed into a political trap.

There also exists an authentic private sector that functions in enemy surroundings and endures constant state, party and mafia racketeering, and the international embargo. There exists an enormous enterprising spirit derived from extensive experience in legal international business undertakings and intensive communication with the world, and from an awareness of the large unexploited resources that lie at hand. Finally, there exists a genuine interest in business circles abroad, in Germany and Italy before all, who were traditionally the most successful partners of the Serbian economy and who regard sanctions as a serious impediment to regaining their dominant roles in the region, for restituting investments, and for transferring technology.

Although it is doubtful that the policy of sanctions might change soon, their all-the-more dubious and counterproductive forms are challenging the model of supporting changes in Serbia through punishing the ones who impede them. Sanctions inhibit changes rather than instigate them. Still, if the game of sanctions continues, then it is high time for business circles to become a target group for partner relations, just as with free towns and municipalities, independent media, non-governmental organizations, opposition parties, etc. Only then can the seemingly consolidated monolith of the regime-controlled economy - that persists largely due to sanctions - be shattered.

## Agriculture in Serbia

### Agriculture in Serbia today...

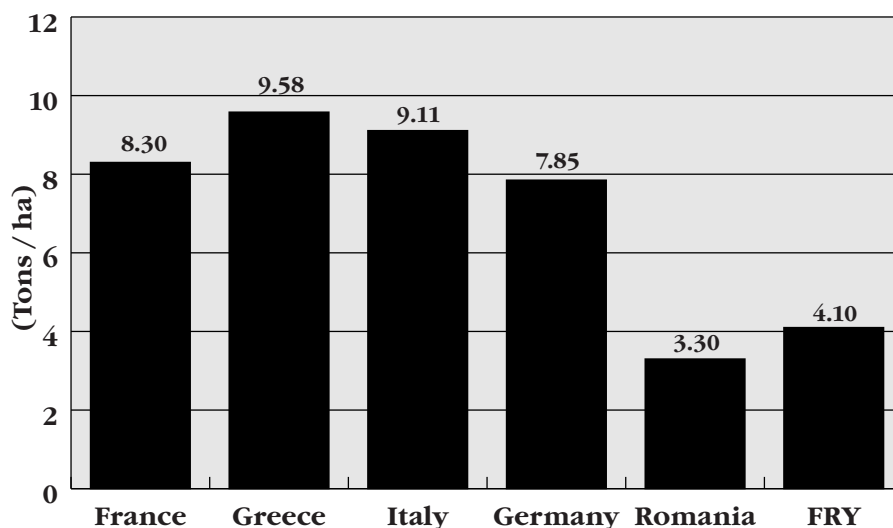
Agriculture occupies an important place in the economy of Serbia, as demonstrated by the following facts: 19% of the total population in Serbia lives from agricultural income, while 60% of that number actively works in agriculture. Recent years mark an increase of the number of farmers that perform extensive agriculture due to the inability to survive by way of their basic activity, a fact that does not appear in official statistical data. The share of agriculture, together with industrial branches that produce input for agriculture and process raw material of agricultural origin, amounts to 48% of Serbia's GDP.

Yugoslavia has 4,875,000 hectares of arable land. Fruit plantations take up 268,000 ha, corn is grown on an average 1,380,000 ha, wheat on 750,000 ha, sugar beet on 63,000 ha, cattle fodder on an average of 1,200,000 ha, potato on 100,000 ha, etc. In the last few years, around 300,000 ha remain uncultivated.

In the period between 1991 and 2000, characterized by a deep and prolonged economic crisis, the agroindustrial complex proved to be the most vital segment of economy. The fall of production in agriculture is considerably lower than the fall of investments into agriculture. This contributed to the maintenance of social peace in a country where the policy of "bread and circuses" was conducted for years back and at all costs, resulting in the disastrous state of agriculture.

**Agricultural  
production  
and processing  
comprise  
48% of GDP**

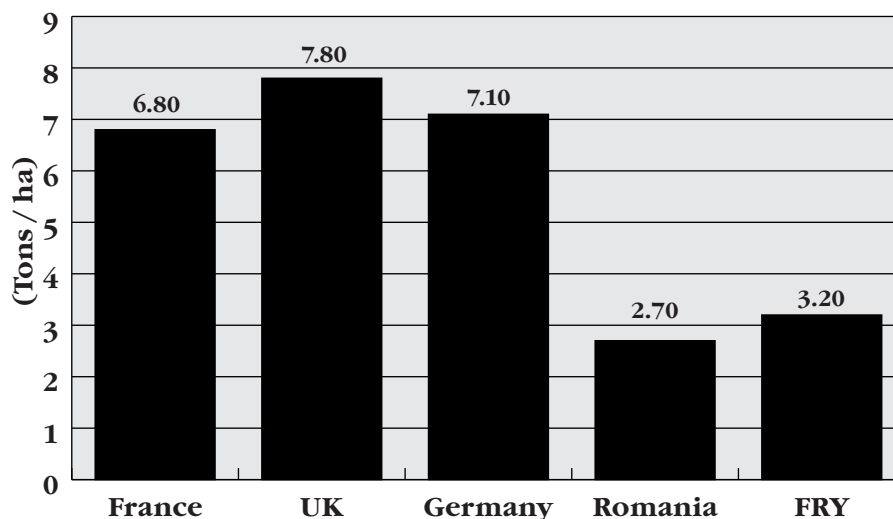
*Average Annual Yield of Corn, 1994 - 1999*



### Agriculture in Serbia yesterday...

Wheat production per unit of area has been in decline for ten years in Serbia. Ranging from the average post-World War II yield of 1.1 t/ha, to the 90's yield of 4.2 t/ha, the one obtained in 1999 was 3.3 t/ha, while this year an average of 2.3 - 2.8 t/ha is projected. A comparison can be made with the 7.7 t/ha yield in England in 1984. The main reason for this state is the declining investment into agriculture and a considerable deviation from optimum production technologies, while the underlying total economic disaster also affects agricultural production.

*Average Annual Yield of Wheat, 1995-1998*



**250,000 ha of land remained uncultivated last year**

**Private producers are deprived of new technologies**

**80% of arable land is in private ownership**

The fact that more than 250,000 ha of land remained uncultivated last year in Serbia is astonishing, as well as that the average corn crop in Serbia in the past ten years was 3.8 t/ha, while it was around 7.7 t/ha in European Union countries. Instead of conducting systemic reforms in agriculture and seeking out real sources of finance, the regime is passing repressive laws such as the Law on Supplements to the Law on Agricultural Land, which penalizes farmers for leaving land uncultivated, without any consideration of the limit of an average agricultural household's financial endurance. If we analyze the mentality of country folk, we realize that their greatest shame is to leave the land uncultivated and unsowed - then we can imagine what misery has befallen our countryside.

Most frequently stated reasons for the drop of yield are unfavorable weather conditions, such as an insufficient amount of rainfall during summer months. But, in years with favorable weather conditions lower average yields were also observed, which implies that other limiting factors are at work. They are, above all: the use of inadequate planting material; shortage of fuel, mineral fertilizers and pesticides; outdated machinery; the low technological level of production; and, principally, the low profitability of production.

Most producers are turning to less accumulative cultures such as wheat, corn, etc., which is not only a consequence of the lack of production investment capital, but also of the low degree of knowledge about new cultivation and processing technologies. The existing Institutes and Agricultural Bureaus have highly trained personnel, but their activities are mainly directed to the state sector, while private agricultural producers are deprived of new technologies.

### The Agricultural and Countryside Improvement Program

Any serious government that genuinely wishes prosperity for Serbia would first have to acknowledge that it is an agricultural country, and aim development strategies accordingly. Development programs cannot be made after rule is acquired, they should be ready for immediate realization. The G17 PLUS Group for Agricultural and Countryside Improvement has assembled many experts from this field and started developing such a program.

The starting point of the program is a complete reorganization of the Ministry

of Agriculture. Agricultural development depends principally upon the application of new technologies, while their introduction and control can be carried out only by a ministry that is organized and qualified according to contemporary standards. Parallel to a reorganization of the Ministry, agricultural estates and collective farms should be privatized so as to enable their functioning in the shortest possible time. Institutes should be put under supervision of the Ministry of Agriculture and actively participate in all development programs.

The picture is no brighter in the field of crop protection. Experts are still managing crop protection on social estates, but the bad situation in the economy is disabling its adequate application. Private estates - which comprise about 80% of arable land - offer a different image. Producers that are well off employ phytopathologists privately, while most are left to their own experience or take the advice of employees in agricultural drugstores that are not qualified according to the Law on Crop Protection standards. Only about 5% of agricultural drugstores employ agricultural engineers.

### State and Structure of Agricultural Technology

Parameters	Central Serbia			Vojvodina		
	Social Sector	Private Sector	Total	Social Sector	Private Sector	Total
Cultivated land (ha)	737,000	4,115,000	4,852,000	563,981	1,085,317	1,649,298
Cultivated land by %	15.2	84.8	100	34.2	65.8	100
Number of tractors in every category	13,300	406,674	419,974	10,000	100,383	110,383
Current cultivated land per tractor (ha)	56.4	10.1		56.4	10.8	
Optimal cultivated land per tractor (ha)	50	20		50	25	
Current average usage of a tractor per year (hours)	900	300		912	430	
Optimal average usage of a tractor per year (hours)	1,200	700		1,300	800	
Current average age of tractors (years)	15	19		15	19	
Optimal average age of tractors (years)	18	12		18	12	
Number of grain combines	3,380	15,787	19,167	2,582	4,427	7,009
Current number of combines per 100 ha	0.45	0.38		0.45	0.40	
Optimal number of combines per 100 ha	0.6	0.7		0.6	0.7	
Number of single axel tractors	206	241,196	241,402	60	22,005	22,065
Corn pickers	268	32,412	32,680	203	21,380	21,583
Various attachable harvesting machines	29,221	1,339,224	1,368,445	22,194	398,280	420,474
Motorized sprinklers	2,069	45,418	47,487	1,502	11,338	12,840
Apparatus for milking	1,681	16,997	18,678	959	6,111	7,070
Self-propelled motorized reapers	136	36,681	36,817	89	2,835	2,924
Silos for grain	approx. 140 in total (estimated total capacity: 600,000 tons)					

While not conforming to contemporary standards, the existing legal regulations represent a solid base for the efficient production and sale of planting material and of safe and effective means for crop protection. However, the problems arise over the regulations' implementation in practice.

### Agriculture in Serbia tomorrow...

Because 80% of arable land is in private ownership, it is realistic to strive for quickly achieving a level of agricultural production close to that of developed European countries, providing that a serious approach to agrarian problems is taken and other macroeconomic problems are resolved. The large extent of rich arable land, high levels of know-how that could quickly be transferred to producers, the proximity of the European market, and the prospects of a fast reconstruction and expansion of infrastructure through an appropriate policy of credits and investment all bode well for the future of agriculture in Serbia.

The program for the political, regulatory and economic changes to enable strong and globally competitive agricultural production is extremely complex. It implies a global strategy as an essential element of state policy, one that gives emphasis to decentralization and free market economy and that systematically decreases state interventionism. Social policy must be separated from agricultural production, so that agricultural development is lead by the business logic of individual farmers rather than political agendas directed from the center.

The program has two phases. The first phase would be a curative process, where raising the technological sophistication of production and processing would be emphasized, along with reconstruction of the old and construction of new infrastructure. Agro-economic research shows that agricultural production development depends primarily upon the application of new technologies. Production would quickly rise as it shifted away from a semi-intensive level with a low degree of capacity utilization.

The program's second phase, after political and economic conditions have stabilized somewhat, entails complex measures of economic policy that would aid the development of strong "family farming" companies as the future basic structure of rural development.

**Social policy must be separated from agricultural production**

### Wheat Harvest 2000

This year's wheat harvest in Serbia (without Kosovo) is modest at best. Only 625,000 ha were sown last autumn. Floods and underground waters have destroyed the yield from 45,000 ha, or 7.2%, so that the harvested area is 580,000 ha. However, weather was not to blame for the yield or quality of grain, because some localities achieved yields of over 6 t/ha.

1,875,000 t of grain have been stored in silos and granaries. The average yield amounted to 3.0 t/ha on harvested and 3.32 t/ha on sown areas. The physical and technological quality barely reaches an acceptable limit. This year's grain harvest is down almost 1,000,000 t from the optimum yield, and down 50,000 t relative to last year. The average yield per ha was down by 0.03 t/ha, and of lesser grain quality. This year's wheat harvest can just barely ensure nourishment security of the population and sup-

ply annual strategic state needs in the amount of 1,500,000 t of grain, while the possibility of exports is insignificant. It should be kept in mind that seeding feed wheat and grains account for part of this yield.

The poor results of wheat production are a direct consequence of bad agrarian policy contributing to very low investments into production (generating, over time, a low agrotechnical level). In the so-called optimum term, only 55% of arable land was sown. The purchase price of 4 din/kg that the state offered is destimulating. Calculations show that an average 3.5 t/ha yield is needed in order to have no loss at the offered price. Unfortunately, less than 30% of produced grain will be offered for purchase. This suggests that supplies of flour and bread will be unstable and that prices are sure to rise.

*Dr Radomir Popović*

In order to solve the accumulated problems in agriculture, the first link of the chain is the village household. Life in a rural community might become more attractive and interesting only if it is understood that not all members of the household must necessarily take part in agricultural labor. To meet this need, developed societies have special funds for low cost micro-credits and loan guarantees to aid the creation and expansion of small and medium-sized companies in rural areas.

A shift to the "farming type" of production should take place, which implies a maximum intensification of production and the application of new cultivation technologies, along with the formation of regional producers' associations in order to facilitate market entry. To compete globally on both price and quality, a network for training agricultural producers in the most modern techniques must be formed, as well as a product quality control network. Expert services should be made easily and constantly available to producers on the local level, under the patronage of the Ministry of Agriculture. A modern information system must be established and available to all producers and organizations via the Internet.

Every agricultural producer must function like a small private company and always be market-oriented, but the main precondition for development is the formation of funds for low-interest credits to support large investments into highly accumulative agricultural projects. State intervention must be limited to the protection of producers and the market from monopolies and dumping, and to defining clear strategic goals for the state's material reserves whose purchase prices will be guaranteed.

A resolution to institutional problems, changes in economic regulations, the minimization of administrative procedures, and, first and foremost, the formation of a real capital market are the key prerequisites for developing agriculture in Serbia. Everything else is pure demagoguery.

**The precondition for development is low-interest agricultural credits**

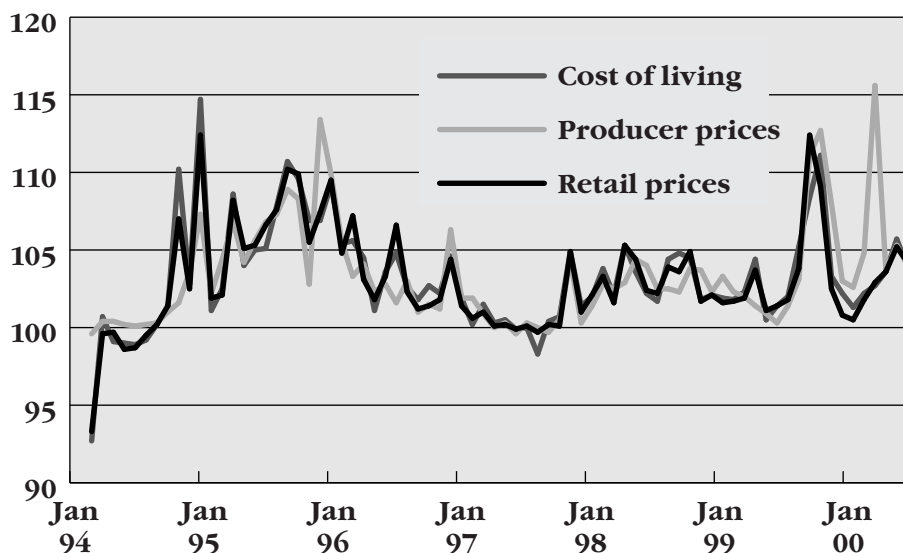


## MACROECONOMIC REVIEW

### Prices

June retail price growth amounted to 4.3% in Serbia, and 2.9% in Montenegro. The two add up to a monthly price growth of 4.2% for the whole country. The FRY inflation rate has more of an accounting than real effect, since there are many obstacles in trade between Serbia and Montenegro, and the FRY market cannot be described as a single one, with uniform prices for the same merchandise.

*Monthly price growth in FRY*



According to official statistical data, prices of agricultural products fell by 7.8%, while prices of industrial products and services rose by 3.8%, or 5.9% relative to May.

### Production

Industrial output in June demonstrates a normal seasonal drop. Month-on-month production fell by 2% in June. As usual, production trends differ in Serbia and Montenegro: Serbia saw a drop of 2.7%, while Montenegro posted a 10.9% rise in industrial production. Equipment and raw material output marked a drop of activity, while, consumer products were on the rise. Metallurgy and nonmetal production, including construction material, recorded the largest individual drop at over 9%, while textile production showed a growth rate of almost 9%.

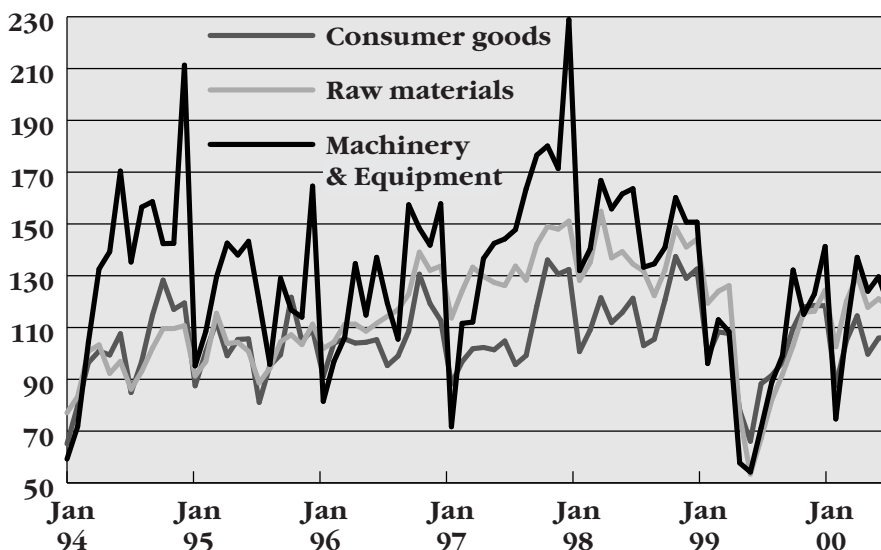
The first half of last year included the conflict with NATO. During that period, the output of consumer goods was better off than equipment and raw material production. After the conflict ceased, things returned to normal. The period of post-war reconstruction marks a slower rate of consumer goods production than that of equipment and raw materials.

As such, the first six months of this year record consumer goods output growth of 13%, equipment output growth of 38% and raw material output growth of 25%, year-on-year.

Total output in FRY during the first six months, year-on-year, was up by 21%. Such growth cannot be maintained until the end of the year, because the base for comparison is much larger in the second half than in the first half of the year. The Review projects that this year's industrial production will exceed last year's by 14%. This, of course, is not enough to return the country's production level to that achieved the year that preceded the conflict with NATO.

While the Yugoslav economy remains in a period of post-war reconstruction, it is not in a stage of economic development. The recession that the country entered before the bombing is still at large. Compared to previous years, production is at the level acquired in 1995-96. The government believes that the basic problem lies in the lack of real aggregate demand, resulting in the inability of maximizing production capacities. However, even if that problem were mitigated - as it was with revenue from the sale of Telekom in 1997, or by a lifting of sanctions - there would not be much space for faster consumer goods and raw material output growth. Outdated technology and low quality merchandise remain serious obstacles to economic growth.

*Industrial production by Sector  
(1999 average = 100)*



### Foreign trade and the exchange rate

Total foreign commercial trade in June did not differ significantly from what was achieved in the previous two months. If we add necessary corrections to import and export data - usually initial export data are lesser than the final by 15 to 20 million dollars, while those for imports are lesser by 50 to 60 million dollars - then the foreign trade level in June amounts to 490 million dollars. Exports account for 165 million dollars, and imports for 325 million dollars. The commodity trade level is somewhat higher than it was in May, and equal to the one in April. Therefore, foreign trade has demonstrated stability in the past three months.

Fluctuations of the real exchange rate of the dinar on the parallel foreign currency market and the level of the trade deficit recorded nonstandard behavior. From the beginning of the year to June, the dinar had rarely appreciated in relation to the German mark. Such movement of the real exchange rate of the dinar has formerly contributed to an increase of the foreign trade deficit. That was the case in the January 1995 - November 1997 period. This year does not show the same pattern. On the contrary, we only perceive oscillations of the deficit around an average monthly level of 185 million dollars.

Similar irregular movement happened in the second half of last year. The dinar constantly depreciated, while an end of the conflict with NATO directly influenced the deficit. Such a relation did not exist in the period between December 1997 and mid-1999, when there was real depreciation of the dinar, while the foreign trade deficit fell. Seasonal oscillations of the foreign deficit happened then as well, while changes of the real dinar exchange rate were less influenced in the same way.

Namely, since June this year another official dinar exchange rate was introduced. It is the so-called stimulative rate of 16 dinars to the German mark. The official and stimulative rates form a new legal rate of 20 dinars to the mark. Two things are important here: firstly, devaluation has not been officially proclaimed so that the financial effects of devaluation are not registered in banking balances; secondly, the new exchange rate to the German mark is still below its parallel market exchange rate. In June the spread between official and parallel rates was down to three dinars, while the spread rose to four dinars at the end of July.

### Monetary policy

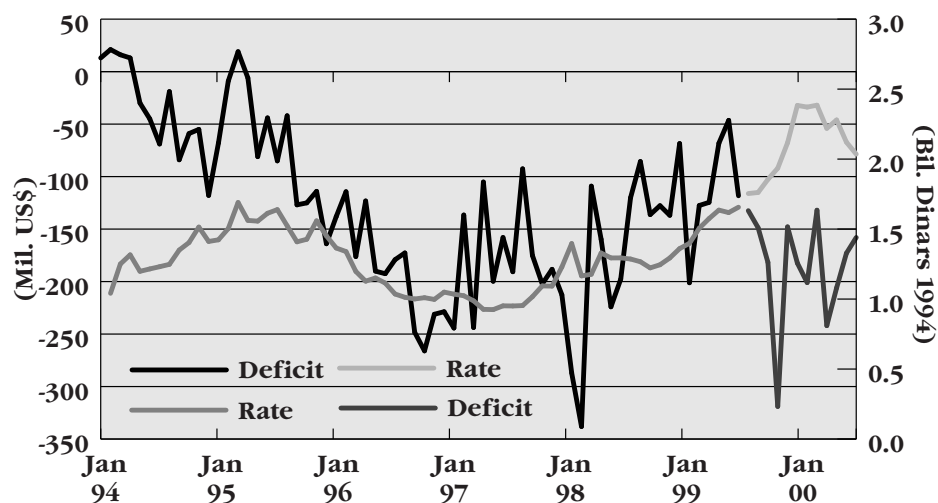
The Yugoslav economy is under monetized, i.e. there is not enough real domestic money on the Yugoslav market. This is a result of mistrust in the domestic currency, and high currency substitution through which the German mark has suppressed the dinar's circulation. From the end of 1997 to June this year, the trend of declining real money mass is easily recognizable.

At the end of May there were 18.7 billion dinars in circulation. Estimates project an increase of at least 1% in money mass, and an additional 4-5% increase in July. In the first seven months of this year M1 money mass increased by over 3 billion dinars, which is an increase of around 19%. Prices, although controlled, rose in the same period by 35%, so that the real money mass decreased.

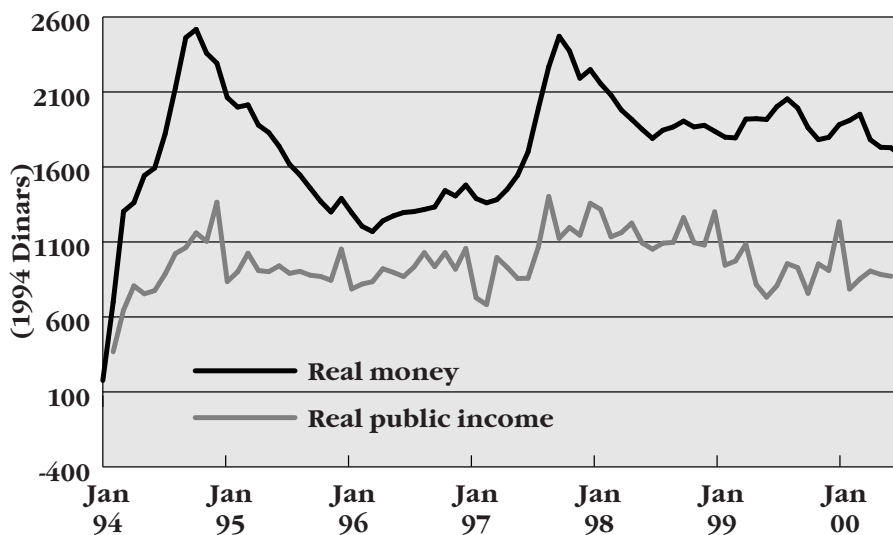
Furthermore, there is a great problem of insolvency in the economy. Transaction demand for money is well expressed by the real mass of public revenue. This should not be surprising since public revenues account for over 55% of GDP. The series of real fiscal revenues shows considerable stability of this variable, in spite of all cyclic fluctuations. Following a certain drop in the months of the conflict with NATO, fiscal revenues are maintaining their real value. As compared to the previous period, these revenues were bigger during the course of 1997 only, as a consequence of a large foreign currency inflow after the privatization of Telekom.

Transaction demand for money is quite stable, while the real supply of money is recording a downward trend. The National Bank of Yugoslavia, however, cannot increase the money issue because that would lower the dinar exchange rate to the German mark and immediately increase the already high inflation. Monetary policy is struggling between trying to maintain stability and incite economic activity. This position cannot be maintained by the NBY for long. With the election period ahead of us - when greater money issue usually covers many accumulated debts - a more expansive monetary policy can be expected.

*Foreign trade and the exchange rate*

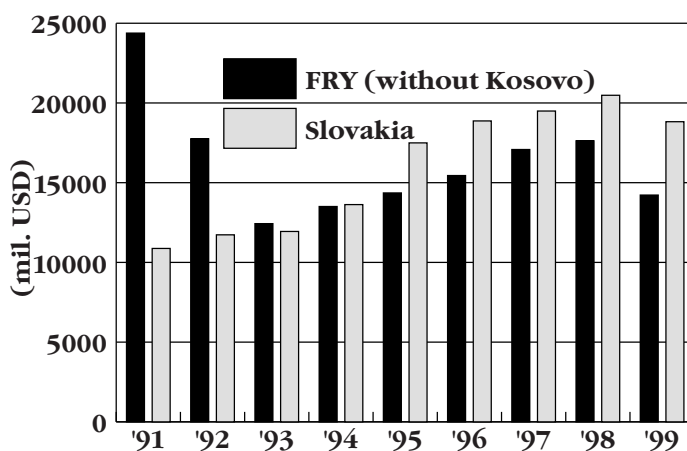


*Real Money and Transaction Demand*

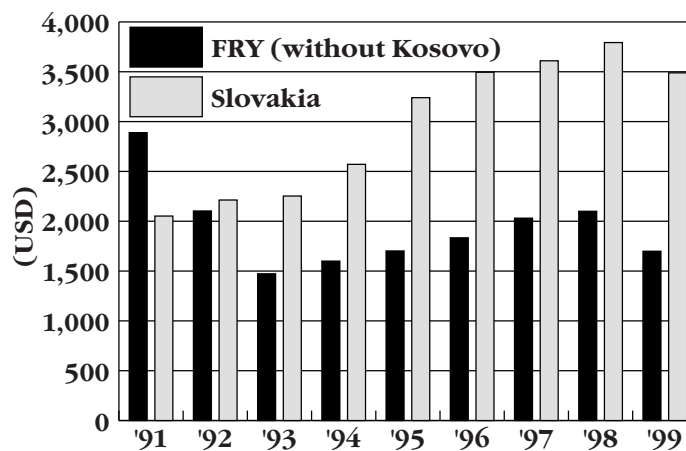


## Yugoslavia in the mirror of Eastern Europe

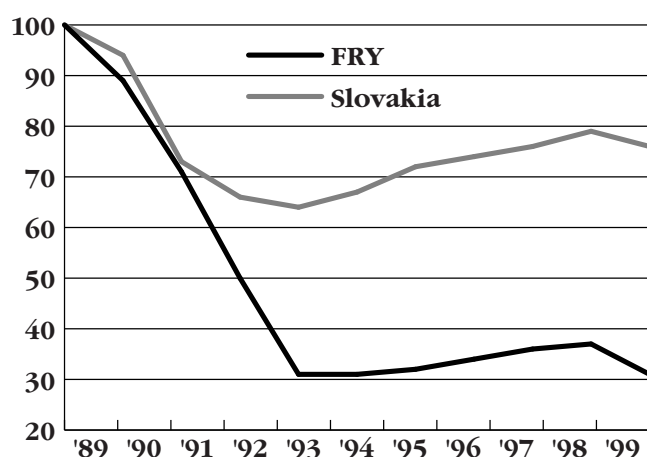
*GDP*



*GDP per capita*



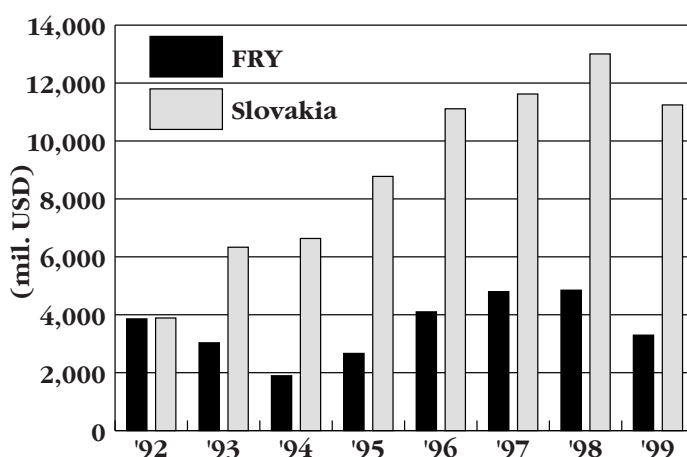
*Industrial Production*  
1989 = 100



*Salaries*  
*Quarterly Averages*



*Import*



*Export*

